Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
Revision of the Rules and Policies for	)	IB Docket No. 95-168
the Direct Broadcast Satellite Service	)	PP Docket No. 93-253

REPLY COMMENTS OF DIRECTV, INC.

DIRECTV, Inc. ("DIRECTV") hereby submits the following Reply Comments in connection with the above-captioned Notice of Proposed Rulemaking.[1]

I. INTRODUCTION

In its initial Comments, DIRECTV expressed general support for many of the Commission's proposals in the Notice, as did many other parties. In seeking to adopt the fastest and most efficient method of re-allocating the DBS orbital locations and RF channel assignments formerly held by ACC, the Commission has tentatively proposed to use an open outcry auction. While the comments are not uniformly in support of this allocation solution,[2] there is a general consensus that competitive bidding is a sensible conceptual approach for the Commission to adopt in view of the unique circumstances surrounding the revocation of ACC's construction permit.

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[1] In the Matter of Revision of Rules and Policies for the Direct Broadcast Satellite Service, IB Docket No. 95-168, PP Docket No. 93-253, Notice of Proposed Rulemaking (released October 30, 1995) ("Notice").

[2] Several DBS permittees and other parties have opposed the use of competitive bidding for ACC's former channels, and/or have urged the Commission to maintain the re-allocation approach proposed in the 1989 Continental decision. See Comments of Continental Satellite Corporation (Nov. 17, 1995); Initial Comments of Direct Broadcasting Satellite Corporation (Nov. 20,,1995); Comments of Echostar Satellite Corporation and Directsat Corporation (Nov. 20, 1995); Comments of Lockheed Martin Corporation (Nov. 20, 1995).

The legal and logical support for this approach, however, depends entirely upon the Commission's decisions with respect to its proposed structural and other limitations on parties' participation in and development of DBS businesses. The Commission's spectrum aggregation rules in particular will affect the universe of parties that will participate in the auction for ACC's former DBS channels, and ultimately, of course, the actual MVPD provider that will make use of this spectrum to provide service to consumers. As DIRECTV stressed in its original comments and reiterates below, it is on this point that the Commission's proposed DBS service rules and re-allocation approach are most skewed. The Commission should at a minimum ensure that DIRECTV and all other parties who do not exercise market power are not precluded arbitrarily and needlessly from having even the opportunity to bid for the full-CONUS DBS spectrum warehoused by ACC.

II. THE COMMISSION SHOULD IMPOSE SPECTRUM AGGREGATION RULES, ATTRIBUTION LIMITS AND CONDUCT RULES ONLY ON MVPDs WHO EXERCISE MARKET POWER

A. Spectrum Aggregation.

DIRECTV's Comments were addressed primarily to the spectrum aggregation restrictions the Commission has proposed with respect to the auction for the full-CONUS DBS spectrum at 110° W.L. On the one hand, the Commission has proposed a rule that would allow the cable industry to bid for and obtain a full-CONUS DBS orbital location. On the other hand, the Commission's proposal would effectively prohibit emerging independent DBS operators like DIRECTV or Echostar from even having the opportunity to compete at auction for the DBS channels at issue. Thus, the Commission's proposed spectrum aggregation rules would have the anticompetitive effect of treating the companies who exercise market power in the MVPD market more favorably than independent MVPDs, which plainly exercise no such power. DIRECTV here reiterates its view that such a result makes no legal, economic or policy sense.

If there is a case to be made for the imposition of spectrum aggregation restrictions in the process of re-allocating ACC's full-CONUS DBS channels at 110°W.L., it should be made against those potential DBS entrants who exercise market power, i.e. cable providers. This point was emphasized repeatedly by DIRECTV and Echostar in the Advanced proceeding before the International Bureau and later the full Commission. It has been made again here, not only by DIRECTV, but by the Department of Justice ("Department").[3/]

The cable-affiliated interests in this proceeding attempt to paint a picture of a fully competitive MVPD marketplace, and a competitive environment that renders any Commission restraint on cable's extension of its market power into DBS a "solution in search of a problem."[4/] The problem, however, could not be more evident. The plain fact is that the MVPD market today still consists essentially of a series of local monopolies controlled by cable television operators. Thus, as the Department observes, the promotion of DBS technology as a vehicle for competition to cable's market power is critically important:

> The Department fully agrees with the Commission's purpose to promote competition in the MVPD market, and with the recognition that unrestrained control of DBS slots by cable systems may threaten such competition. Firms that own cable systems which have monopoly power in some geographic areas are likely to have different economic incentives than DBS providers who are unaffiliated with cable systems. DBS entrants who are unaffiliated with cable systems can be expected to offer products and set prices

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3/ Comments of the United States Department of Justice (Nov. 20, 1995).

4/ See Comments of Continental Cablevision, Inc. (Nov. 20, 1995), 10; Comments of the National Cable Television Association (Nov. 20, 1995), at 2.

> in ways that will maximize their profits in the DBS business. A DBS operator affiliated with cable systems, however, is likely to offer DBS products and prices that will maximize its aggregate profits both in DBS and cable. Since such a firm will wish to protect its monopoly profits in the cable business, its could have less incentive to offer DBS service that competes against cable.

Comments of the United States Department of Justice (Nov. 20, 1995) at 6 (emphasis in original).[5/]

DIRECTV fully supports the Department's market analysis and believes that its proposed structural rules with respect to cable participation in DBS have merit.[6/] As the development of DIRECTV's business has shown, DBS has the potential to become a

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5/ See also Declaration of Jerry A. Hausman at ¶ 29 ("Hausman Declaration") (Attachment 1 to Consolidated Reply of DIRECTV, Inc. (Dec. 16, 1994)) ("Overall, when a new system emerges to provide competition with an existing system or network, important economic incentives exist for producers of the new system to cooperate to provide enhanced competition to the existing system . . . . Allowing TCI and Primestar to own any more of the DBS spectrum than they already own will lessen the possibility that DBS will succeed and lessen the much needed competition to cable TV operators who currently exercise monopoly power"). This Declaration, submitted by Professor Hausman at the Bureau phase of the Advanced proceeding, has been incorporated by reference by DIRECTV into the record here, see Comments of DIRECTV at 12, 16, nn. 23 & 31, and is re-attached hereto for the convenience of the Commission.

6/ Contrary to the suggestions of the various cable providers in this proceeding and their trade association, Commission imposition of structural limitations on cable participation in DBS is entirely consistent with its earlier decision in Tempo II. Even before DBS had become a reality when the Commission considered granting a conditional DBS permit to TEMPO, several parties expressed the strong concern that TCI's extensive cable system holdings, coupled with its earth station (satellite uplink) facilities and its interests in at least twelve cable programmers, would result in undue concentration of control in the video services marketplace if a DBS system were added to its holdings. Continental Satellite Corporation, 4 FCC Rcd at 6298. The Commission ultimately granted TEMPO a DBS authorization, but pledged to exercise its continuing oversight to prevent any actions that would be "deleterious to the DBS industry and its customers, or to operators and customers in the other video entertainment services as well." Id. Now that DBS has become a reality, the Commission's imposition of more concrete structural limitations on cable participation in DBS is entirely appropriate in view of cable's market power, and consistent with the Commission's "oversight" pledge.

powerful and close substitute -- rather than a complement -- to cable television.[7] Given cable's still-overwhelming market power, the Commission should seek to ensure that the development of potentially cable-competitive distribution technologies will not be impeded, either by regulatory policy or by the actions of monopoly cable systems.[8]

On the other hand, no party commenting in this proceeding has proffered any legitimate basis for the Commission's other proposed spectrum aggregation rule -- a separate "intra-DBS" spectrum aggregation limit that would effectively bar qualified MVPDs like DIRECTV from even bidding on the full-CONUS DBS spectrum at 110° W.L. At best, these parties have simply parroted the unsupported concern over DBS "concentration" expressed in the Notice. Furthermore, while certain cable-affiliated MVPDs have urged that any structural restrictions or spectrum aggregation rules be applied uniformly to all MVPDs based upon a vague notion of "competitive equity," this is simply a self-serving fallback that

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7/ See Hausman Declaration at ¶ 21 (noting that "it is quite clear that DBS will be a substitute, not a complement, for cable television given these services' large degree of overlap in programming"); see also Comments of the United states Department of Justice at 3.

8/ Comments of the United States Department of Justice at 3. In this regard, it is clear that large cable firms or consortia of such firms "have strong incentives to use any DBS license in ways that would not undermine monopoly cable profits." Id. at 8. In fact, the cable industry and its DBS affiliates have never seriously refuted this point. Primestar, for example, has always stressed the "complementarity" of its business with the businesses of its cable owners. See Comments of Primestar Partners, L.P. at 22 n.49 (stating that the "provision of DBS is in fact a logical extension of the basic business of cable operators"). Similarly, Continental Cablevision, a Primestar Partner, states that it regards "DBS as a natural outgrowth of its cable business . . . . DBS allows Continental to serve more efficiently subscribers in sparsely populated areas." See Comments of Continental CableVision (Nov. 20, 1995), at 5-6. Such facts merely underscore the Department's view, with which DIRECTV concurs, that "there will be a significant risk of more subtle forms of curtailed competition if large cable systems are permitted to control DBS channels," and that even if one full-CONUS DBS slot were fully occupied by a cable-affiliated DBS provider, "DBS competition with cable will be significantly reduced." Comments of the United States Department of Justice at 6.

would have the Commission ignore any analytical or policy distinction between those MVPD providers who exercise market power and those who do not.[9]

A regulatory approach that facilitates the acquisition of additional market share by the incumbent monopolists, while simultaneously restricting one of the few new entities that has demonstrated the potential to bring true competition to the market, makes no sense. Targeted marketplace intervention is necessary and appropriate to prevent anticompetitive market effects from or behavior by MVPDs who exercise market power, which cable operators and their affiliates undeniably do.[10] For all the reasons that the Department has cited in its Comments, and the Commission in the Notice, there are compelling reasons for the Commission to restrain cable provider expansion of market power into DBS; conversely, there is absolutely no reason to constrain other MVPDs who lack such market power.

Thus, DIRECTV believes that the present record provides strong support for its position. A spectrum aggregation rule on independent DBS providers would be arbitrary and capricious.[11] On the other hand, such a rule applied to cable providers makes sound policy sense, and is fully supported by economic analysis and comment in the record. If, however, the Commission nevertheless decides not to impose a bar on cable-affiliated MVPDs applying for the orbital locations formerly occupied by ACC, then the potential for

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9/ Comments of Tempo DBS, Inc. at 9; see Comments of Primestar Partners, L.P. (Nov. 20, 1995), at 23.

10/ See, e.g., 137 Cong. Rec. S 582 (daily ed. Jan. 14, 1991) ("Policies aimed at promoting competition and preventing market abuses simultaneously advance diversity in the marketplace of ideas.") (statement of Senator Danforth introducing S.12).

11/ See Cincinnati Bell Telephone Co. v. FCC, Nos. 94-3701/4113; 95-3203/3238/3315 (6th Cir.) (Nov. 9, 1995) (Commission's attribution rules must be rationally related to evidence of potential anticompetitive behavior, particularly where application of standard results in complete ban on participating in spectrum auction).

anticompetitive conduct mandates the imposition of the conduct rules proposed by DIRECTV in its Comments and referenced in Section II.B. below.

B. Conduct Rules.

In the event that the Commission permits cable companies the opportunity to gain a full-CONUS foothold in DBS, DIRECTV reiterates once again the need for cable-specific[12] conduct rules. These rules will help ensure that cable-affiliated DBS service is not simply offered as adjunct to cable operations.

Moreover, the Commission should reject the cable industry's typical invocation of the antitrust laws and the Primestar consent decrees as sufficient checks against cable's anticompetitive behavior to render the creation of additional conduct rules unnecessary. The Primestar consent decree protections are quite narrow, and are scheduled to expire in 1997 in any event. The antitrust laws were supplemented by the program access provisions of the 1992 Cable Act precisely because they were and are not enough to prevent the many instances of cable's market power abuses in dealing with other MVPDs.

As DIRECTV, the Department of Justice and others have noted, there is already a strong case for precluding entirely large cable MSO participation at full-CONUS DBS locations. If the Commission decides to override these compelling policy considerations, it should at least ensure that mechanisms are in place to guard against the anticompetitive behavior that is likely to occur. DIRECTV therefore urges the Commission

[12] As noted in DIRECTV's initial Comments, there is no justification for applying such rules to encompass MVPDs who do not exercise market power, and therefore the Commission should make them cable-specific.

to adopt the conduct-specific rules it has proposed in the Notice, as supplemented by those that DIRECTV has proposed.[13]

C. Attribution Rules.

Finally, as DIRECTV pointed out in its initial comments, both the spectrum aggregation limitations (Notice at ¶¶ 34-40) and the proposed conduct rules to protect competition (Notice at ¶¶ 54 - 63) refer to DBS operators that are affiliated with "non-DBS MVPDs." Although these rules logically should be focused only on cable-affiliated entities that exercise MVPD market power (for the reasons mentioned above), the Commission's current prohibitions seem to sweep well beyond cable operator/DBS affiliations and may preclude other more pro-competitive alliances among non-cable-affiliated MVPDs. Moreover, the overly broad application of these rules is even more troubling when combined with the Commission's proposed attribution threshold for implementing its spectrum limits, which would attribute any ownership interests of 5% or more, and could in addition define attributable interests to arise in connection with certain management and joint marketing agreements.[14]

Other parties have echoed DIRECTV's concern. NYNEX, for example, properly notes that "of all the potential MVPDs, only the incumbent CATV providers have any measurable [market] power."[15] NYNEX observes:

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[13] See Comments of DIRECTV, Inc. (Nov. 20, 1995), at 15-21; Hausman Statement at ¶¶ 25-30; Attachment 2; Notice at ¶¶ 55-56; see also Comments of United States Satellite Broadcasting Company, Inc. (Nov. 20, 1995), at 6-7 (proposing conditions that would prohibit several different types of tied deals between DBS and affiliated cable operators).

[14] See Notice at ¶ 48.

[15] Comments of NYNEX (Nov. 20, 1995), at 3.

> It would be truly ironic in this proceeding -- required by the failure of a DBS licensee to develop its system after many years -- if DBS providers generally were barred or dissuaded from forming relationships with non-CATV entities which might make them better able to provide "effective competition to the services provided by cable systems," as envisioned in the Commission's goals. A reasoned approach to the video services market structure and its own statutory mandate require that the Commission distinguish between entities with and without market power as it seeks to encourage a competitive services market.

Comments of NYNEX, Inc. (Nov. 20, 1995) (emphasis and footnote omitted).

DIRECTV agrees.[16/] There is simply no reason for the Commission to implement a sweeping limitation that covers any MVPDs beyond cable at this stage of MVPD market development. Alliances among emerging MVPDs -- e.g. wireless cable operators, TVRO providers, telephone or long distance companies and/or existing DBS operators or permittees -- could all yield pro-competitive and pro-consumer results in curbing cable's MVPD market power, which the Commission should encourage rather than dissuade.

III. CONCLUSION

Unlike other services in which the Commission has proposed to use competitive bidding as a spectrum allocation mechanism, the universe of potential bidders for DBS spectrum is relatively small, in part because of the high capital costs required to launch a DBS business. Thus, in order for the federal government to maximize its recovery of the value of the DBS spectrum formerly held by ACC, and for the public to benefit promptly from the current competitive development of DBS service, it is in the public interest for the

16/ See also Comments of the National Rural Telecommunications Cooperative (Nov. 20, 1995), at 5 (Commission should "recognize that any restrictions on cross-ownership should be targeted against and limited to cross-ownership relationships between DBS operators and cable entities, rather than all MVPDs").

Commission to create the most diverse and widest possible base of qualified bidders in the auction.

DIRECTV believes that current DBS operators and permittees, telephone companies and long distance carriers, and perhaps even cable companies -- if properly constrained by conduct rules -- could be a formidable base of bidders to determine the highest and best use of the spectrum warehoused for over a decade by ACC. The spectrum aggregation rules proposed in the Notice, however, by unduly restricting some of the MVPD markets most qualified bidders, could effectively replicate one of the most offensive aspects of the original ACC/TEMPO transaction by giving those companies with MVPD market power -- and the incentives to see DBS fail -- the ability to purchase a prime full-CONUS location at a bargain basement price. This result is not in the public interest.

Respectfully submitted,

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November 30, 1995

Declaration of Professor Jerry A. Hausman

1. My name is Jerry A. Hausman. I am MacDonald Professor of Economics at the Massachusetts Institute of Technology in Cambridge, Massachusetts, 02139.

2. I received an A.B. degree from Brown University and a B.Phil. and D. Phil. (Ph.D.) in Economics from Oxford University where I was a Marshall Scholar. My academic and research specialties are econometrics, the use of statistical models and techniques on economic data, and microeconomics, the study of consumer behavior and the behavior of firms. I teach a course in "Competition in Telecommunications" to graduate students in economics and business at MIT each year. Service provision by cable providers, the introduction of new competition to cable providers, and competition with broadcast TV is one of the primary topics covered in the course. In December 1985, I received the John Bates Clark Award of the American Economic Association for the most "significant contributions to economics" by an economist under forty years of age. I have received numerous other academic and economic society awards. My curriculum vitae is included as Exhibit 1.

3. I have done significant amounts of research in the telecommunications industry. I have published numerous papers in academic journals and books about telecommunications. I have also edited two recent books on telecommunications, Future Competition in Telecommunications (Harvard Business School Press, 1989) and Globalization, Technology and Competition in Telecommunications (Harvard Business School Press, 1993).

4. I am generally familiar with the direct broadcast satellite (DBS) industry. I first did research on DBS in the early 1980's when I served as a

consultant to Sears and Comsat on the commercial viability of DBS. I have continued to follow the industry since that time. I have also studied DBS and cable competition in the United Kingdom and the prospect for DBS in Australia. After an extremely long period of development, DBS has finally reached the stage of technology where it may provide programming services to consumers which will allow it to succeed economically. I believe that DBS has the potential to be a long term competitor to cable television in the distribution of multichannel video programming.

5. I have been asked by DIRECTV, Inc. (DIRECTV) to review the competitive consequences of the proposed assignment of Advanced Communication Corporation's (ACC's) DBS construction authorization to TEMPO DBS, Inc. (TEMPO), a wholly-owned subsidiary of Tele-Communications, Inc. (TCI), the nation's largest cable operator. Specifically, I have considered the competitive consequences of the proposed transfer in a relevant product market of multichannel video programming distributors (MVPDs), which currently is dominated by cable providers exercising dominant market power. I have also considered the effects of the proposed transfer on overall competition and the ability of DBS providers and other alternative MVPDs, who are just beginning operations, to offer competition to cable.

6. I have concluded that the proposed transfer of ACC's DBS authorization and channel assignments to TCI will have significant negative consequences for emerging competition in the MVPD marketplace. Promoting the emergence of alternative distribution technologies like DBS is the best way to introduce effective competition to cable's exercise of monopoly power on video programming distribution. Such competition will remove the FCC from its current extensive involvement in regulating cable rates, and will yield many benefits to consumers. I do not believe that these competitive goals will be

achieved by allowing TCI or its affiliate Primestar, which is owned by TCI and five other large cable MSOs, to acquire more high-power DBS orbit spectrum. ACC's proposed assignment does not serve the public interest because it will lead to decreased competition to cable operators which would otherwise occur from independent operation of DBS channels

7. In this regard, I also reply to a number of claims made by Dr. Bruce Owen in his declaration submitted on behalf of TEMPO/TCI. Dr. Owen's economic analysis leads to the absurd conclusion that no decrease in competition would occur if the FCC permitted cable operators to control all of the DBS spectrum. He also ignores the potential decrease in competition which arises from the vertical nature of cable operators' control of both distribution and a significant amount of programming. Lastly, Dr. Owen does not analyze correctly the incentives of cable operators with respect to DBS competition and the current market power exercised by cable operators.

I. Important Pro-Consumer and Pro-Competitive Benefits Will Arise from DBS Competition to Cable TV, but the Lack of Effective Competition in the MVPD Industry Leads to the Conclusion Against Allowing More Cable Participation in DBS

8. Economists, government regulators, and Congress have concluded that cable operators have market power and have engaged in various anti-competitive actions.[1] In particular, authors of a number of articles published in economic journals, economists at both the DOJ and FTC, my own analysis, and Congress have determined that cable operators' prices to consumers reflect the exercise of market power, defined as the ability to price above competitive

[1] Only about 0.5% of cable networks in the U.S. have a competing cable system in the same locality. According to the recent FCC Report, "Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming" (September 19, 1994), very little overbuild activity is currently ongoing in the U.S.

levels for extended periods of time. The most recent FCC 1994 Cable Report confirms the continued existence of significant market power of local cable operators:

> "Today, most local markets for multichannel video programming distribution services are supplied by monopoly cable systems. At present, competitive rivalry in most local multichannel video programming distribution markets is largely, often totally, insufficient to constrain the market power of incumbent cable systems." ("Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming", September 19, 1994, p. 112).

Anti-competitive problems arise not only from the local market power of cable operators who charge supra competitive monthly subscription prices, but also from the vertical integration of these cable networks multiple system operators (MSOs) into video programming.[2] This vertical integration has led to reduced quality of video programming for cable subscribers as noncable affiliated programmers have been unable to secure carriage on cable systems. Vertically integrated programmers have the incentive and the ability to favor their affiliated cable operators and programming distributors using other technologies. While over the air broadcasting and video cassettes do compete to some extent with cable programming, they are not close enough competition to hold down cable prices to competitive levels.

9. While Congress chose to impose price regulation on the cable industry, Congress and almost all industry analysts agree that a better solution is to encourage greater competition. DBS providers and eventually

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[2] According even to the National Cable Television Association, basic cable rates more than doubled from $9.20 in 1984 to $18.85 in 1992. (NCTA, Cable Television Developments, 6-A, June 1993) In real terms (adjusted for inflation), the price increase is approximately 50%. The real price for most telecommunications serviced decreased over this same period.

the telephone companies (LECs) will be the most likely long-term competitors to cable companies. DBS programming has become available in 1994, but DBS still faces various hurdles to emerge as a successful MVPD competitor. The FCC should follow a policy which will attempt to maximize the possibility of success for DBS given the substantial benefits to consumers if it succeeds, because DBS will provide increased competition with cable TV.

10. Dr. Owen agrees that the relevant market for purposes of evaluating the competitive consequences of the ACC/TEMPO transaction is multichannel video program distribution. (p. 2) While this market definition is logical, it is important to note that the services offered in this market are differentiated products. Thus, the closeness of substitution among the services must be considered, including their state of development.[3]

11. Dr. Owen in his discussion of market definition (pp. 5-6) emphasizes that cable will compete with DBS, but he finds little cause for concern in evaluating the instant transaction--because the relevant market is "at least cable television, VDT systems, MMDS providers, SMATV systems, TVRO providers, and possibly in the future, LMDS systems." While I agree with Dr. Owen's market definition, the fundamental error in Dr. Owen's analysis is that he does not take into account: (1) the differentiated nature of these services and the varying amounts of competition they provide or (2) the continued pervasive market dominance of cable television providers in the MVPD industry, recently affirmed by the FCC's examination of MVPD competition in the 1994

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[3] The DOJ and FTC Merger Guidelines (April 2, 1992) recognize the importance of differentiated products or services: "In some markets the products are differentiated, so that products sold by different participants in the market are not perfect substitutes for one another. Moreover, different products in the market may vary in the degree of their substitutability for one another." (Section 2.21) See J. Hausman, G. Leonard, and D. Zona, "A Proposed Method for Analyzing Competition Among Differentiated Products", Antitrust Law Journal, 1992 who discuss the usefulness of market definition with differentiated products.

Cable Report.

12. For example, Dr. Owen bases a major portion of his conclusion on the extremely optimistic and speculative prediction that the seven RBOCs and GTE will provide sufficient competition to cable providers by 1996 to provide sufficient price constraints to end the exercise of market power by cable operators. The reality is that significant regulatory and legislative uncertainty exists over whether the telephone companies will provide video services to <u>any</u> of their customers by 1996, let alone a majority of them.[4] Dr. Owen's conclusion about the complete elimination of cable's dominant market power in a brief two-year span seems to be merely an unsupported assertion that is not based on economic analysis or a realistic estimate of the degree of MVPD competition or effective competition to cable that will exist in the next 2-3 years.

13. Indeed, based on Dr. Owen's market definition and subsequent analysis, no competitive problem would arise if TCI or Primestar acquired <u>all available DBS frequency</u>: "That means that even a complete consolidation of DBS channels into the hands of a single operator would not convey market power..." (Owen, p. 7) I find this result to be absurd because, as I explain below, cable operators have greatly reduced incentive to cannibalize their own MVPD market share by competing with their current cable systems. Dr. Owen's mistaken view of competition in the MVPD marketplace and flawed analysis lead to a conclusion which simply does not make economic sense.

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[4] See the 1994 Cable Report (p. 120) which concludes that "a number of issues remain unresolved with respect to the LECs in the delivery of video programming." Similarly, Dr. Owen emphasizes the role of MMDS, SMATV, and C band satellites. (p. 6) However, if these distribution media were as important as he claims, I would not expect to see the continued market power of cable operators which the 1994 Cable Report emphasizes.

14. While cable operators will not control all of the DBS frequencies if TEMPO acquires ACC's orbital slot and DBS channel assignments, cable operators will effectively control two of the three most valuable DBS orbital locations (ACC's at 110° and TEMPO's at 119°). I understand that these locations are the most valuable locations because they clearly cover the entire continental U.S.[5] Given that DBS is currently operating and provides new competition to current cable monopolies, the FCC will be in the rate regulation business for the foreseeable future if it permits the cable industry to dominate the alternative distribution technologies which are likely to most quickly provide competition to cable. Competition protects consumers better than regulation; the FCC should allow the competitive forces of DBS to operate.

II. Current Cable Operators Have a Reduced Economic Incentive to Cause DBS to Succeed

15. A current cable operator which also has DBS spectrum has a reduced economic incentive to cause DBS to succeed, compared to an independent DBS operator such as DIRECTV. Because the coverage of DBS is nationwide, the market for DBS will be the entire United States. When a company such as DIRECTV considers a new investment in programming, it makes the calculation of whether the incremental revenue created by the new programming will more than cover the incremental cost of the investment.

16. However, when a DBS operator is also a cable operator, an additional consideration enters the decision of whether to make the

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[5] See M.S. Alpert and M.L. DeSonne, DBS: The Time is Now (NAB 1994, pp. 19-21). They conclude that while all orbital positions are valuable as spectrum allocations, from the perspective of DBS provides "interested in maximizing their chances for success in serving the entire continental U.S. market," the "position at 101° W. and 110° W. seem to be the most preferable...followed by 119° W."

investment. The cable operator must account for the loss of business to its cable operations which the new investment in its DBS operations will cause. To the extent that cable TV and DBS are direct competitors (substitutes to the consumer), this extra consideration will lead to lower investment by the joint cable TV/DBS operator. Competition will be reduced as well.[6]

17. The reduced incentive for a joint cable TV and DBS operator to provide competitive service to cable depends, in part, on the size of the firm's cable operations. For a small cable operator of minimal size which also provides nationwide DBS service, the competitive effect of DBS on its cable operations could well be minimal. However, for a large cable operator who also provides DBS the effects are likely to be significant. Thus, the larger the cable operator, the more incentive it has not to compete with itself through a DBS venture.

18. The current application involves the assignment of the DBS construction permit from Advanced Communications Corporation (ACC) to Tempo DBS which is a wholly-owned subsidiary of TCI. TCI is by far the largest cable operator in the U.S. with approximately 26% of all cable homes served by its operations. (FCC 1994 Cable Report, Table 1A, p. G-2). Only one other cable company (Time Warner) has a total share which exceeds 6%. TCI also owns over 20% of Primestar along with the five other largest cable MSOs. Primestar currently operates a medium-power DBS service.[7] TEMPO's DBS license has long

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[6] Economies of scope between cable TV and DBS could, in principle, lead to lower costs for the joint operator. However, I am not familiar with any demonstration of the existence of significant economies of scope between cable TV and DBS.

[7] The Department of Justice claimed in the Primestar Partners case last year that Primestar was formed to "suppress and eliminate DBS competition in the deliver of multichannel subscription television programming to consumers." United States v. Primestar Partners, L.P. et. al. (June 23, 1993)

been expected to facilitate Primestar's entry into high-power DBS, and this expectation is confirmed by the ACC assignment application.[8] The MSO owners of Primestar together serve about 25 million cable subscribers, which is well over 40% of all cable subscribers. Thus the MSO owners of Primestar, and TCI in particular as the owner of TEMPO, have the largest negative incentive of any cable companies to have DBS compete with their currently highly lucrative cable operations.

19. A simple hypothetical example demonstrates how this negative incentive operates. TCI currently serves about 15 million cable households. Suppose its incremental revenues (price minus variable cost) for these households is $5 per month. If TEMPO/Primestar is considering the introduction of a new service or is considering lowering the price for its DBS service, the incremental revenues must not only cover the incremental costs, but must also exceed the number of TCI's cable customers who would switch to DBS multiplied by $5 per month. Since for the foreseeable future DBS will have a subscriber base much smaller that 15 million subscribers, the negative disincentive for TCI to offer DBS services which will take away a significant number of cable customers will be very large.[9] Thus, competition of TEMPO/Primestar to cable TV is lessened considerably compared to the situation in which an independent DBS company provides the service.

20. Dr. Owen understands the reduced incentives in this situation. Indeed, Dr. Owen made the mistaken argument that Pacific Telesis should not be

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[8] Primestar recently announced that it will begin offering up to 200 channels of high-power DBS service in 1996 using dishes ranging from the current 36 to 18 inches. ("Consumers will receive enhanced DBS," Business Wire, October 20, 1994).

[9] The 1994 Cable Report indicates that DBS households will be in the range of 5-10 million by the year 2000. (p. 113)

permitted to purchase the cellular spectrum of Communications Industries in 1985 and 1986 because he claimed that cellular would be a substitute for landline telephone. He claimed that Pacific Telesis would have reduced economic incentives to develop cellular because of its assumed substitutability.[10] Of course, Dr. Owen was mistaken because cellular turned out to be a complement, not a substitute, for landline telephone. That is, cellular telephony has led to increased use of the landline network, rather than decreased usage.

21. In this case, however, it is quite clear that DBS will be a substitute, not a complement, for cable television given these services' large degree of overlap in programming. Thus, cable operators such as TCI or the Primestar Partners will have an economic incentive not to compete as much or as vigorously with DBS as would an independent DBS operator. Dr. Owen never disputes this point; instead he merely assumes this possibility away: "Even if PRIMESTAR did have the inclination to avoid competition in its owners' territories, effective competition from others now and in the near future makes following that inclination untenable." (Owen, pp. 8-9) Only Dr. Owen and the cable industry believe that effective competition exists now, or will exist in the near future, to Primestar's cable MSO owners. In fact, the 1994 Cable Report comes to just the opposite conclusion. Thus, Dr. Owen again has assumed his answer rather than providing any analysis or data which would permit the conclusion that effective competition exists now, or will exist in the near future, to cable operators.

22. TCI, Time Warner, and the other Primestar Partners have a very high degree of ownership in national programming services. (FCC 1994 Cable Report,

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[10] See e.g. Affidavit of Bruce Owen in McCaw Communications of San Francisco and McCaw Communications of San Jose vs. Pacific Telesis Group, U.S. District Court for the Northern District of California, February 1986.

Table 6, pp. G11-G13). DBS requires programming services to compete successfully with cable TV. The FCC has imposed regulations which guarantee access by DBS operators to cable TV programming. However, the fact remains that programming suppliers in which TCI or any one of the Primestar Partners have a significant interest in are influenced or are controlled by cable operators who have a reduced economic incentive to create new programming which DBS can use to compete with cable TV. These cable operators must consider the negative effect that DBS will have on the profits of their businesses when affiliated programmers is used in competition with cable.

23. In addition, programmers must have a sufficient audience to be able to create new programming profitably. Advertisers also are more willing to buy time and to pay higher rates (on a per viewer basis) when audience size is larger. Allowing cable operators to control both cable and DBS decreases the available outlets for new programming. For example, the large majority of Primestar programming is supplied by its owners' vertically integrated programmers. This means that new programming created by non-vertically integrated programmers will find it difficult to achieve sufficiently high distribution to gain economically attractive revenues over time. Thus, less new programming will be created over time. Vertically integrated suppliers have the incentive and ability to favor their affiliated cable operators as the 1992 Cable Act found.[11] Given the existence of FCC rate regulation of downstream cable operations, this incentive has only increased since 1992. Given this negative competitive effect, TCI/TEMPO/Primestar should not be permitted to acquire even <u>more</u> DBS capacity than the significant number of channels that TEMPO already owns.

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[11] Indeed, modern economic theory finds that this situation exists when an upstream provider can cause decreased entry or exit in the downstream market. That situation exists exactly here since the cable operators have the economic incentive to deter downstream entry or even to cause exist if they can.

24. This outcome harms independent DBS providers such as DIRECTV because decreased amounts of new programming makes them less competitive with existing cable operators. DIRECTV aims to attract significant numbers of current cable customers to choose DBS. An important part of the choice of viewers is available programming.[12] Allowing cable operators greater entry into DBS increases the possibility that they can use exclusive arrangements or other practices to deny popular programming to independent DBS competitors. Currently DIRECTV cannot carry HBO, MTV, and Nickelodeon as most cable operators do because vertically integrated programmers have negotiated exclusive arrangements with DIRECTV's competitor USSB. As a result, many DBS subscribers are buying service from both DIRECTV and from USSB to receive these channels.[13] The monthly cost of buying both DBS offerings is between $50-60 per month which makes DBS less attractive to consumers. DIRECTV and other DBS operators will need significant amounts of new programming to be able to compete with current cable operators. Allowing vertically integrated programmers to further decrease competition from the independent DBS industry will be exacerbated by allowing more cable control of DBS spectrum allocations. Decreasing the available outlets for new programming by allowing TCI or Primestar to acquire additional DBS channels, will reduce the amount of new programming and competition to current cable monopolists and will create greater opportunities for cable and affiliated DBS operators to behave anti-competitively.

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[12] Dr. Owen states that no competitive problem exists because the Primestar partners have ownership interest in "only" 28 of the 107 national programming services. (Owen, p. 13). This 26% ownership interest is significant, but once again Dr. Owen does not recognize the differentiated nature of cable programming. All cable programming is not of the same competitive significance, and the Primestar partners control a significant amount of the most popular programming.

[13] Paul Kagan Associates, Marketing New Media, November 21, 1994, p. 2.

III. Independent DBS Providers will Create Positive Externalities which will Increase Competition. These Externalities and Competition will be Greater if TCI and the Other Primestar MSOs Do Not Control 1/3 of the DBS Spectrum

25. If TCI is permitted to combine ACC with Tempo, it will control 76 DBS channels or 30.4% of all high power DBS spectrum. Given TCI's large investment in cable TV, it has an economic incentive to retard the success of DBS. Its control of approximately 1/3 of the DBS spectrum will enhance its ability to retard the future economic success of DBS.

26. A significant barrier to the economic success of DBS is likely to be the cost of the home satellite dishes. Economic research has demonstrated that consumers tend to place "too high" a value on required initial investments compared to cost savings later.[14] Currently, DBS satellite receiving hardware is priced at about $700-900 which represents a significant investment by a typical household.[15] The potential future success of DBS will be increased greatly if this initial cost can be reduced substantially. An important way in which the price of the DBS receiving hardware can be reduced is if its cost of production is reduced because of economies of scale and learning by doing in its production. Again an independent DBS operator will have the economic incentives to encourage adoption of DBS and will take account of economies of scale and learning by doing in its economic strategy.[16] Thus, an independent DBS competitor will create positive externalities for all DBS companies, including lower equipment costs. Other

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[14] See e.g. Jerry Hausman, "Individual Discount Rates and the Purchase and Utilization of Energy Using Durables," Bell Journal of Economics, 1979. Thus, consumers behave as if they have an extremely high discount rate. My original findings have been subsequently verified in a number of different situations.

[15] M.S. Alpert and M.L. DeSonne, DBS: The Time is Now, (NAB, 1994), p. 72.

[16] Learning by doing causes cost to decrease as overall output increases. Indeed, cost decreases of 35% for every doubling of output is not uncommon in electronics products.

positive externalities will be created by independent DBS providers such as overall consumer acceptance of DBS and digital technology which is often an important factor for new product introductions.[17]

27. If TCI is permitted to acquire more of the DBS spectrum, positive economic externalities for DBS will be reduced. TCI will need to take into account that reduced prices for DBS hardware and greater consumer acceptance will allow DBS to provide additional competition to cable TV. Thus, permitting the largest cable TV operator to own a large portion of the DBS spectrum can lead to reduced economic success for the entire DBS industry. Independent operation of ACC's channels will lead to increase positive externalities and greater competition which will benefit both DBS consumers and consumers of cable TV.

28. Dr. Owen claims that competition among DBS providers is important and that the FCC should level the playing field to permit Primestar to "compete more effectively" with DIRECTV. (Owen, p. 13) But for DIRECTV to succeed it must be competitive with the cable industry, and DIRECTV will benefit if the DBS industry succeeds overall. The cable industry currently has monopoly control over the MVPD marketplace, and DIRECTV needs to attract cable customers (not non-existent DBS customers) if it is to provide competition to cable operators. Thus, Dr. Owen's emphasis on competition among DBS competitors (pp. 4-5) is misplaced. The real competitive question is whether DBS can compete effectively with current cable operators. In my view, the prospect for a negative answer to this question varies directly with degree of cable company participation in this early phase of DBS development.

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[17] This pattern of a given growth rate of initial consumer acceptance followed by an increase in the growth rate after "early adopters" have demonstrated the value of a new product is common in marketing analysis of new product introductions. Indeed, the experience in cellular telephone in the U.S. followed just this type of pattern.